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11 March 2016

European Banking Authority (EBA)
One Canada Square (Level 46)
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Ref: EBA/CP/2015/27

Dear Sir / Madam

Consultation Paper: Assessment Methodology regarding compliance with the requirements to use internal models for market risk and assessment of significant share

Barclays welcomes the opportunity to comment on the EBA's Consultation Paper (CP) on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use internal models for market risk and the assessment of significant share, and valued the opportunity to attend the public hearing at the EBA's offices on 25 January 2016. The key aspects of our feedback are summarised below while the Appendix contains responses to the questions for consultation.

The mandate established in CRR Article 363(4) requires the EBA to propose the assessment methodology that competent authorities should apply when permitting institutions to use internal models and the conditions under which the share of positions covered by the internal model should be considered significant. However, we consider that the CP goes beyond this mandate, particularly where it imposes new or additional requirements over and above the CRR. While we understand the EBA's objective to establish a harmonized regulatory framework, we believe that numerous requirements are overly prescriptive and impose a rigid set of requirements on all firms without recognizing the fact that compliance with the CRR can be achieved in different ways according to the firm's own business model and governance structure. We consider that it is essential to maintain scope for competent authorities (CAs) to exercise their judgment when assessing compliance with the CRR requirements. The Regulatory Technical Standards (RTS) should provide guidance for CAs in terms of the criteria and methods to be applied when assessing the overall quality, systems and approaches adopted by firms rather than mandating the modeling and governance requirements that firms must meet.

Barclays understands that the EBA's mandate for this CP did not include increasing the level of capital firms are required to hold. We believe there are several proposals that could increase capital requirements including removal of zero PDs and derecognition of the consolidated VaR/SVaR treatment. We recommend that these proposals should be revised to articulate the criteria and methods that CAs use when verifying the integrity of the model output rather than potentially imposing additional capital requirements on banks. In addition, the revised regulatory requirements under the CP are likely to impose a considerable burden in relation to ongoing compliance with the RTS, particularly where additional governance processes are required. We recommend that the EBA considers both ongoing and initial costs for firms and CAs as part of their cost-benefit analysis.

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Barclays considers that the timing of the proposed requirements in the CP does not align well with the regulatory changes and model developments that will be required under the Market Risk Standards issued by BCBS in January 2016 (also known as the Fundamental Review of the Trading Book or FRTB). We expect many firms will need to completely overhaul their market risk models and infrastructure in order to meet FRTB requirements. Since this CP is likely to require a significant allocation of resources for both banks and CAs at a time when the primary focus is on the model development required for FRTB, we consider that it is essential that the RTS requirements and timescales should be aligned as far as possible with the FRTB in order to allow firms time to devote resources to the new market risk framework. This will enable banks and CAs to address the changes in an orderly manner thereby optimising resources and minimising associated implementation costs.

In particular, we are concerned that the timing of following requirements in the CP is not well aligned with FRTB:

- The existing capital requirements regime, which is based on Basel 2.5, emphasizes rolling out model coverage to the whole of a firm's portfolio, and the EBA proposals support this impetus with a threshold of 90-95% for assessing whether a firm's share of modeled market risk is significant. The new market risk standards under FRTB focus on both overall and desk level model performance and so will require a much lower level of aggregate market risk capital (10%) to be modeled. We believe a lower threshold in the RTS would be more appropriate given the objectives of the new regime.

- The proposals in the CP would bring forward the requirement to provide a period of 250 days of stable backtesting (as part of an application for model approval) ahead of the FRTB requirement. We believe that this would discourage firms from making appropriate changes to their internal model methodologies ahead of the new market risk standards. By the time the FRTB standards are in place we expect firms will have the capacity to meet this requirement, however, we do not believe it should be implemented prior to that.

As noted above, we consider that the CP goes beyond the EBA's mandate given the prescriptive nature of the requirements proposed. We believe that this will divert resources away from FRTB model development and discourage model enhancements under the existing market risk framework. Although the objectives of the CP are to harmonize the criteria and methods used to assess firms' compliance with the requirements for using internal models for market risk and assess significant share, we believe that all of these objectives are achieved under the new market risk standards.

If you have any queries, or would like to discuss any points made in this letter, please do not hesitate to contact me.

Yours faithfully

Anthony Mason

Managing Director
IB Risk

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BARCLAYS

Appendix: Responses to questions for consultation

<table>
<tr><th>No</th><th>Question</th></tr>
<tr><td>1.</td><td>What are stakeholders' views regarding the two proposed interpretations for the capture or exclusion of an institution's own creditworthiness as a risk factor in internal models (non-default only), and consistent treatment for back-testing purposes?

Given the subjectivity and operational challenges around implementation of own creditworthiness on own debt as a risk factor, we believe that this should be excluded from both internal models and the P&L used for backtesting in order to achieve a consistent scope. This treatment would be consistent with:
The exclusion of gains and losses on derivative liabilities resulting from changes in own credit standing under Article 33(1)(c) of the CRR and the treatment of firms' holdings of own debt for standard rules under Article 327.
The conclusion in the EBA's Technical Advice on the treatment of own credit risk related to derivative liabilities (EBA/Op/2014/05).
FRTB final rules which require that DVA is removed from P&L for backtesting.
In addition, we believe that the treatment of hedges against own creditworthiness on own debt should be treated consistently with own creditworthiness itself in order to avoid potential backtesting exceptions due to a misalignment of risk factors between the model scope and the P&L.</td></tr>
<tr><td>2.</td><td>What is industry current practice in this regard for VaR, SVaR and IRC?

As far as we are aware, there are varying current practices across industry members with respect to VaR, SVaR and IRC. While some firms apply a full derecognition of own debt credit standing for all internal models, we understand that some firms include this risk factor in both internal model scope and in the P&L used for backtesting.

We agree that clarification on the approach to own creditworthiness will help to standardize industry practice and help firms to ensure appropriate changes in the fair value of trading instruments are included in the model scope.</td></tr>
<tr><td>3.</td><td>What are the main operational challenges?

Robust measurement of own creditworthiness can be challenging, therefore inclusion in the model may be problematic for some firms if there is no available time series that could be used as a proxy for the credit spread component.

Exclusion from the model would require identifying and tracking positions where there is exposure to own debt, not only in cash positions but also where they are a constituent part of an index or other multi name product. As a result, calculating risk and P&L for an index position could be operationally challenging for some firms if they are unable to decompose the index to its constituents.</td></tr>
<tr><td>4.</td><td>Do stakeholders agree with the General-Specific model application hierarchy introduced by the RTS?

We do not agree with this hierarchy as there is nothing in the CRR that requires it. In addition, under the FRTB the concept of separate approval for general market risk and specific market risk does not exist. We suggest that this proposal should be removed from the RTS given the fundamental changes to internal models that will be required under the new market risk standards.</td></tr>
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5.	**Do Stakeholders consider that the categories of instruments listed above provide an appropriate guide to assess the complexity of an internal model?** We note that the PRA have already established four product categories which are used to define the scope of the permission to use internal models. The first two categories proposed by the EBA are broadly aligned to the first two established by the PRA while the EBA's third category corresponds to the PRA's categories 3 and 4. As a result, the EBA's third category covers a wide range of product types which vary considerably in terms of complexity and availability of market data. This means that RTS requirements tied to the EBA's product types may not differentiate appropriately between the various types of products covered by this category. Please refer to our response for question 35 in this regard.
6.	**Do stakeholders agree with the use of two differentiated approaches for general and specific risk to assess the significance of positions included in the scope of the model?** Under the new market risk standards, there is no concept of general and specific risk and so the framework for assessing the significance of positions included in the internal model will be fundamentally different. We suggest that this proposal should be removed from the RTS given the fundamental changes to internal models that will be required under FRTB.
7.	**What levels do stakeholders consider are appropriate for the proposed thresholds? Please provide your answer considering the calculation before and after positions have been excluded by the competent authority?** We consider that the ranges for the proposed thresholds relating to the proportion of positions within the scope of the model (before and after exclusions by the competent authority) set too high a threshold for banks to meet in order to obtain initial model approval. We also note that the proposed threshold is significantly different from the minimum modeled threshold under FRTB of 10% of market risk capital requirements coming from IMA approved desks. Since the framework for model coverage under the FRTB will be fundamentally different, we believe it would be more appropriate for the EBA to recognise the direction of travel under the new market risk standards and set a much lower threshold.
8.	**Do stakeholders agree with the two metrics required to assess regularly the relevance of positions excluded from the scope of the internal model?** In our view this proposal is too prescriptive. We believe that the RTS should be revised to give CAs the scope to determine the metrics that are used to review the significance of the positions of each risk category for which permission is sought. With respect to the metrics proposed by the EBA, while the own funds metric has the benefit of simplicity and availability, it is not as sensitive as the P&L measure to the underlying risk profile since it relies on the standardised approach for non-modelled positions. As a result, variations in the proportion of modelled risk capital from quarter to quarter could be driven by the mix of positions on standard rules which may imply that the positions excluded from the model are growing when this is not actually the case. We believe that the P&L metric is more suitable as an indicator of such growth and so propose that this is the only measure used for this assessment. This would also be consistent with the requirement in the FRTB to use P&L based metrics for desk-level approvals.
9.	**What are stakeholders views regarding the proposed requirements on the internal committee structure?**

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	The scope of the internal committee structure "relating to the aspects of model approval" is not particularly clear since the responsibilities of committees with respect to modelled market risk will vary. Most firms establish a governance hierarchy which involves committees at differing levels of the organisation with different responsibilities for modelled market risk. We would appreciate further clarity on this in order to understand the scope of the requirement in relation to the mandate of the RTS. While we agree that the internal committee structure should be clearly laid down in internal documentation, we also consider several of the EBA's proposals to be too prescriptive and in some cases impractical since committees (including the Board) are not suited to making decisions on day to day trading activities. In particular, we note the following comments: • The proposal for the committee structure to be approved by the Board is only feasible for certain senior management committees since for lower level committees this is not a matter that requires attention at such a senior level. • The proposal for a 'risk committee' to approve limit breaches or propose corrective actions is not practical with regard to daily trading activity. We suggest that the requirements be revised so that competent authorities have the flexibility to review the firm's committee structure in light of its enterprise risk management framework and business model.
10.	**Do stakeholders agree that the internal validation requirements are relevant and capture all material risks?** We consider that the requirement in Article 23(2)(b) relating to analysing backtesting 'gains' against a 1% percentile is not relevant to backtesting using the two daily P&L calculations. Instead it is relevant to backtesting using hypothetical portfolios that is described in Article 23(2)(f) since this backtesting process is intended to identify structural features of the portfolio which could equally be highlighted by a gain that breaches the positive VaR level.
11.	**Are there any missing elements that should be incorporated or current elements that may be too burdensome?** The scope of the internal validation requirement covers numerous elements including the appropriateness of proxies, analysis of stress test results and the adequacy of the implementation of the model in IT systems. This implies that that a broad interpretation of 'validation' would meet the scope requirement (as confirmed by the EBA during the Public Hearing). Since a Global Systemically Important Institution (GSII) would be required under the RTS to have a fully independent validation unit (the third option), all internal validation activities within the scope of the requirement would have to be performed by a fully independent unit. We consider this to be too burdensome since we believe numerous elements can be validly performed by the risk control unit with appropriate review by an independent unit. In our understanding, several banks have implemented such an approach to validation and remain compliant with CRR requirements. In addition, this requirement for a GSII appears to be in contradiction with CRR Article 369(1)(b) which requires that the risk control unit conducts the initial and ongoing validation.
12.	**Do stakeholders agree that the proposed requirements on limit structure, regular limit update and limit breach approval processes are appropriate?** We agree with the principle that firms should have formal governance processes in place for limit setting, monitoring and review as well as for limit breaches. We do not, however, consider that it is necessary for

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	tasks relating to limit monitoring and control of breaches to be formally assigned to a committee. Banks adopt a governance framework that is commensurate with their business model, organisation structure and approach to enterprise risk management. As part of this, many firms have implemented a hierarchy of limits of varying importance with governance and monitoring processes that differ according to the category of limit. While it is appropriate that the 'top of the house' limits are set by the Board, there are multiple limits below this level for which this is not appropriate. As a result many firms have followed the principle of individual accountability and assigned responsibility to a particular role (e.g. the CRO or Head of Market Risk) for setting lower categories of limits. In addition, monitoring of limits is typically to particular roles with delegated authority for approval of breaches and temporary limit extensions. Instead of the EBA's proposed approach, we suggest that the requirements be revised so that CAs review the governance framework and delegated authorities that the firm has adopted for limit monitoring and assess whether these are appropriate in light of the firm's structure and business model. In line with the above comments, we consider that: • it is not necessary for the committee that established a limit to deal with a breach of the limit • for all VaR limits, if a breach exceeds a certain threshold it should not always be escalated to the Board, instead only excesses relating to the 'top of the house' VaR limits should go to the Board • it is not necessary to have mandatory jurisdiction level limits since these can be owned by a local management body for smaller jurisdictions where the risk exposure is immaterial at a group level
13.	**Do stakeholders agree with the rationale to provide some flexibility for the introduction of new products?** We agree with the rationale and the possibility of allowing flexibility in the introduction of new products.
14.	**What are stakeholders' views regarding the specific limitations introduced in the RTS regarding the delegation of authority to the new product committee?** We consider that the proposed limitations regarding the delegation of authority to the new product committee are appropriate.
15.	**Do stakeholders agree that the model should have been working in a stable way during a minimum period of 250 days prior to application for permission to use the model?** We consider that the proposal for the model to have been working in a stable way for at least 250 business days to be too onerous and brings in the requirement ahead of the FRTB. We believe that this would discourage firms from making appropriate changes to their internal model methodologies that may be required under the CRR. By the time the FRTB standards are in place we expect firms will have the capacity to meet this requirement, however, we do not believe it should be implemented prior to that.
16.	**Do stakeholders agree that the results obtained for the portfolios published by the EBA during this period are useful for validation purposes?** We do not agree that the results from the benchmarking portfolios are useful for validation purposes since the market data used by the firm at the time of running the portfolios would potentially be quite different from that used by banks with existing model approval and so the results of the applicant would not be comparable to those previously submitted by other banks. More generally, we believe that this requirement is too prescriptive and so we recommend that the RTS be revised to allow CAs scope to review the supporting documentation for a model application and the firm's evidence to demonstrate that its internal models have a proven track record of accuracy.

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17.	**Do stakeholders agree with the requirements related to the model accuracy track record and Stress Testing programme?** We note that the EBA have issued a consultation paper on draft guidelines on stress testing and supervisory stress testing which is due to close on 18 March 2016. In addition to the fact that firms may be required to comply with EBA requirements on stress testing contained in two separate pieces of legislation, many of the requirements in the CP on the assessment methodology are more prescriptive than the Stress Testing CP or are inconsistent. We suggest that the EBA removes the requirements relating to the stress testing programme from the CP on the assessment methodology and updates the final draft of the Stress Testing RTS to reflect any non-overlapping guidelines not currently included.
18.	**Do Stakeholders have any additional comments or concerns regarding the requirements outlined in the governance section?** Regarding the robustness of IT infrastructure, we do not believe that it appropriate for the RTS to state that 'no major system breakdowns shall occur' during the 250 days prior to the initial approval of the model. Instead the RTS should acknowledge that if major system breakdowns occur, the firm should undertake appropriate governance and remediation. This would include investigation of the root cause, resolution of related IT issues and recalculation of affected risk metrics where applicable. With respect to the integrity of positions, we consider that the RTS is unnecessarily prescriptive in stating that all positions and instruments in the internal model should be reconciled daily between risk management, front and back office systems. The RTS should recognize that position reconciliations are not the only way to ensure completeness and accuracy of position data. For example, a bank may use a combination of controls over the scope of trading books, risk feeds, system performance and daily variances. Furthermore, typically not all variables relating to positions and instruments are fed to back office systems, therefore it may not be possible to perform such reconciliations between the risk management system and the back office system. We would propose that this requirement be amended to state that the competent authority should verify that the institution has adequate controls in place over the integrity of internal model positions and, if applicable, daily reconciliations. The list of circumstances where justifiable differences can exist in Article 34 (2a to 2c) would then apply whichever approach the firm has taken to ensure the integrity of positions. While it is desirable for a firm to retain documentation on the specification of its market data provider's industry codes as well as any automatic data filtering or detection that takes place for market data, we consider that it is not practicable to document the precise time of capture of each data point. Large, internationally active banks capture many data points on a daily basis and there can be variations in the time of capture which could be driven by a variety of factors. It would impose a significant operational burden if a firm had to document the precise time that each one was captured every day in order to use it in an IMA model.
19.	**What are stakeholders' views on the proposed requirements for the computation of VaR and P&L at consolidated level?** Each of the three possibilities for VaR and SVaR at the consolidated level creates challenges and has implications for backtesting. The first possibility (single simultaneous risk factor capture and VaR) will not be feasible for many risk factors since the time series will not be available in the region where the simultaneous risk factor capture is required. Even where time series are available, it would impose a significant operational burden since it would require firms to capture two time series for many risk factors. The investigation into backtesting exceptions would be problematic since the time series would not align to the market drivers observed

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	locally and may not have driven a market move greater than the 99th percentile at the local level. The second possibility (joint VaR based on different timing for risk factor capture) aligns most closely to what we believe is current industry practice. We consider that this approach strikes an appropriate balance between theoretical accuracy of a single VaR number and practical implementation for firms with both local and global portfolios. As a general principle, we agree that the VaR and P&L should be calculated consistently since it enables backtesting to function more effectively as a test of the VaR model; we believe that this approach most closely aligns to that principle. The third possibility (non-consolidated VaR) would involve derecognition of the consolidated treatment permitted by Article 325 which in turn could significantly increase the capital requirements for those firms that currently have such a permission. We believe it is beyond the mandate of the EBA to potentially impose such an increase as a result of this RTS. More generally, we consider that the requirements for the calculation of VaR and P&L at a consolidated level are too prescriptive. Instead we believe that the RTS should require firms to document the basis for their VaR and P&L computations and the extent to which these are consistent, and then require CAs to review the firm's justification for its calculation methodology and scope.
20.	**Do stakeholders' agree with the distinction between 'global' and 'local' price risk factors?** We would observe that there is often no clear distinction between global and local price risk factors since there can be a spectrum of price observability with risk factors traded in one or more geographic areas and prices dependent on global and/or local market drivers.
21.	**What are stakeholders' views on the burden a more frequent update than monthly creates? What are stakeholders' views on the burden a daily update for the historical VaR might create?** Where market data is available daily, a more frequent update than monthly would not, in our view, create a significant burden for large, internationally active banks.
22.	**For "partial use" IMA, do you agree with the use of a hypothetical P&L calculated from mark to market P&L including all pricing factors of the portfolio´s positions?** We do not agree that hypothetical P&L should include all risk categories that relate to the portfolio's positions. The rationale for this is that, as suggested by the EBA, hypothetical P&L backtesting should apply as a 'pure' statistical test of the adequacy of the model and as such the P&L should only capture the risk stemming from risk categories within the model scope. We do not consider that the inclusion of P&L from all risk categories would ultimately lead to inclusion of a larger set of risk factors since: • The firm may not have the modeling capability or market data to risk certain risk categories accurately • The firm would not be able to include risk categories within scope until it has supervisory approval and so it would be required to apply for permission for both general and specific risk categories at the same time. We suggest that the RTS should be revised to include a requirement for CAs to verify that the scope of the hypothetical P&L computation is in line with the scope of VaR model and confirm that the backtesting methodology is sufficient to demonstrate the accuracy of capture of all material price risks covered by the approved model scope. More generally, we note that under the new market risk standards, the requirements for risk theoretical

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	P&L are subject to further calibration and so we do not consider it appropriate to introduce this proposal in light of the ongoing work by BCBS to finalise the P&L computation under FRTB.
23.	**If your answer to Q22 is no, what impact does this have on the P&L used for back-testing purposes and how do you monitor the appropriateness of the model? Are there alternatives to ensure a proper reporting to senior management?** Where, for a given risk category, a firm has approval to use internal models for general risk but not specific risk it can be operationally challenging to strip out idiosyncratic components from hypothetical P&L that are not in the VaR scope. In line with the general principle of consistency of scope of VaR and P&L, we believe that hypothetical P&L backtesting should the key mechanism for monitoring the appropriateness of the model and therefore the hypothetical P&L scope should be aligned with the VaR scope as far as possible. In order to address this, we recommend that the RTS be revised to allow CAs to review the adequacy of the backtesting methodology and the drivers of backtesting exceptions. Where exceptions are deemed to be due to material risk factors not captured in the VaR model the CP should allow the CA to have flexibility to require additional mitigants (such as capital add-ons) to be put in place.
24.	**What are stakeholders' views regarding the relative merits of the inclusion of all risk factors for the actual P&L computation?** We understand that the primary purpose of backtesting using actual P&L is to test the adequacy of capital resources held by the firm against potential losses arising from positions within the scope of internal models. As a result, we believe the risk categories included in the actual P&L computation should in line with the scope of the internal model approval. If the actual P&L computation included risk categories outside the model scope the firm could experience backtesting exceptions driven by risk factors that are capitalized under standard rules. Rather than apply to the CA for the addend to be based on hypothetical P&L only in line with CRR Article 366(4), we believe that it would be preferable to have a consistent scope from the outset. This approach would also be in line with the general principle outlined by the EBA in Article 36 that the computation of the P&L for backtesting should be consistent with how the VaR is computed.
25.	**What are stakeholders' views regarding the proposed definition of 'Net interest income'?** In our view, net interest income applicable to positions in the trading book should include explicit interest income (e.g. coupons) and, to the extent that the trading area pays or receives interest internally, funding costs and the cost of carry. Given the fundamental nature of changes coming in under the new market risk standards, we believe that banks should not be required to make substantial changes to the definition of actual P&L ahead of the new requirements.
26.	**What are stakeholders' views regarding the requirement to assess the importance of intra-day and new trades to determine the VaR and SVaR multipliers?** Since backtesting using actual P&L takes account of intraday activity and new trades, we agree that this can be used as one of the measures to assess the significance of such activity; however, we do not agree that it should be used to determine the VaR and SVaR multipliers. Instead, we suggest that this reference should be removed from point 11 of Article 40 since CAs already have scope to allow firms to base their

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	backtesting addend on hypothetical P&L only and can use alternative measures to assess intraday risk (see response to question 27). We also consider that capturing the intraday risk exposure in the model via intraday IT batches would be very onerous and in many cases impractical.
27.	**What alternative methodology, if any, might be appropriate to capture this intra-day risk?** Backtesting and P&L attribution using actual P&L can provide a broad measure of intraday risk although it is worth noting that numerous other risk factors also impact actual P&L. The requirement to capture intraday risk would be most relevant to business areas that are exposed to heightened levels of intraday risk, such as algorithmic trading, and so RTS requirements should focus on these areas of trading activity. We recommend that the RTS be revised to require firms to monitor their intraday market risk exposure where it is material, for example algorithmic trading, while CAs should be given flexibility to review the firm's monitoring and governance processes for intraday risk.
28.	**What are stakeholder's practices regarding adjustments computed less regularly than daily?** We believe that firms typically include valuation adjustments calculated less frequently than daily in actual P&L for backtesting. We agree with the EBA's proposal that competent authorities should be permitted to exercise their judgement in determining whether backtesting exceptions caused by such valuation adjustments indicate a deficiency in the internal model.
29.	**What are stakeholders' views regarding the treatment of Theta in VaR and as a component of P&L?** We consider that theta should not be included in either VaR or hypothetical P&L given that theta reflects the passage of time and that firms typically model VaR based on an instantaneous shock. In addition, we believe that the general principle outlined by the EBA under Article 36 of the CP should apply here in that the computation of the P&L for backtesting should be consistent with how the VaR is computed.
30.	**Taking into account the CRR requirement to capture 'correlation risk' do you consider that the use of stochastic correlations should be required?** Given the challenges in modelling stochastic correlations and sourcing time series mentioned in the CP, we do not believe that it is appropriate to require the use of stochastic correlations. We suggest that the RTS be revised to reflect that where a CA concludes a firm's exposure to market implied correlations is material, it may require a capital add-on to be put in place. In addition, we suggest that Article 46(1)(b) should be amended such that the CA assesses the validity of market data used to support correlation assumptions applied in the VaR calculation.
31.	**Do stakeholders agree with the additional requirements introduced for banks using empirical correlations?** Our understanding of the EBA's use of the term 'empirical correlations' in Article 46(2) is that it refers to correlations which are explicitly estimated from historical data. In this context, we understand this requirement to be aimed at banks using parametric or Monte Carlo VaR models rather than historical simulation. In our view, the RTS requirement for firms to review correlations monthly is too prescriptive. In addition, the requirement to use high and low correlations as part of the periodic validation process does not reflect the fact that a firm can use alternative methods of testing the soundness of correlation assumptions and still remain compliant with CRR requirements. Therefore the CP should state that as part of the periodic validation process, firms should be able to demonstrate that their correlation assumptions are sound and implemented with integrity so that CAs can review this evidence as part of their assessment.

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33.	**Do you agree with the elements that should be considered when assessing any internal reserves and/or the VaR and SVaR multiplication factors?** We believe that the list of elements is very prescriptive and should not be, de facto, reflected in the VaR and SVaR multipliers without supervisors having scope to apply their judgment and consider mitigants, such as capital add-ons, quantitative analysis and the availability of market data. We suggest that the RTS be revised to allow CAs to consider the list of elements and mitigating factors in their assessment of the multiplication factors.
34.	**Do you agree that the SVaR multiplier should always be the same or higher than the one used for VaR purposes?** We do not see a need for the SVaR multiplier to be floored by the VaR multiplier. We consider that: i) some of the criticisms that apply to VaR do not apply to SVaR ii) SVaR was implemented under Basel 2.5 to mitigate some of the concerns about levels of capital during the financial crisis and so it is not viewed as a test of model performance and is not backtested.

35.	**Do Stakeholders have any additional comments or concerns regarding the requirements outlined in the VaR section?**
	
	We note that requirements in Articles 42, 43 and 46 refer to the EBA's product categories in Article 7. Although the EBA has not consulted explicitly on the requirements that are linked to product categories we would like to raise the following concerns:
	• Under Article 42, firms holding material positions in categories 2 and 3 must assess the extent to which risk factors included in the pricing model but excluded from the risk measurement model are immaterial. The implication is that firms with material positions must ensure the excluded risk factors remain immaterial. However, we suggest that it would be more appropriate for CAs to assess the materiality of positions in categories 2 and 3 and require the firm to implement add-ons to capitalize for such missing risks where applicable.
	• Under Article 43, firms would not be permitted to hold material positions in Category 3 options if they use Taylor series approximations which do not capture the underlying risks adequately. Again we do not think it is appropriate to prevent firms from holding such material positions since a capital add-on could be implemented to mitigate the risk.
	• Under Article 46, firms holding material positions in category 3 options are deemed to have a material exposure to market implied correlations. However, we note two points in this regard:
	  o barrier, digital and path-dependent options on a single underlying in category 3 are not exposed to market implied correlations
	  o Article 46(1)(b) requires that category 3 products should not be included in the VaR calculation if market data is not available to support the correlation assumption. If competent authorities take the view that appropriate market data is not available (e.g. unobservable correlation parameters for which it is not possible to directly perform independent price verification processes) then a significant proportion of the option portfolio held by a firm may need to be excluded from internal models. This could cause a material increase in firms' capital requirements.
	
	We recommend that the EBA revise these Articles to ensure they define the standards that firms should meet with respect to risk capture and capital mitigants rather than prescribing the methodology and scope of positions that firms use for their internal model. Under the RTS, a firm should have the scope to choose its model methodology as long as it remains in line with CRR requirements relating to that model and CAs should be given the flexibility to review the firm's documentation and justification for its modeling choices.

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36.	**Do stakeholders consider that any proxy validated for VaR should be acceptable for SVaR purposes?** We do not agree with this statement. A risk factor that does not have reliable time series for VaR may still have reliable time series or a valid proxy for the SVaR period, for example, a stock where the company has been taken over or an off-the-run index.
37.	**Do stakeholders have any additional comments or concerns regarding the rest of requirements outlined in the Stressed VaR sub-section?** We do not have any additional comments on this sub-section.
38.	**Do stakeholders agree with the EBA interpretation regarding the treatment of event risk for credit positions after the implementation of IRC?** We agree with the EBA's interpretation regarding the treatment of event risk for credit positions and the conclusion that the requirements for event risk relate entirely to equity risk. A corollary to this point is that backtesting exceptions for credit positions which are driven by event risk should not be viewed as a deficiency of the VaR model since there is no need to model event risk in VaR.
39.	**What are stakeholders' views regarding the capture of the FX position stemming from Banking Book activities and the treatment proposed in the RTS?** In our view, FX risk is a VaR type risk and should have the potential to be included in VaR-based capital. We would observe that, in our own modelling, where we have complete and reliable time series we capture FX risk on banking book activities in our aggregate VaR. We believe that the treatment in the CP regarding measurement of an add-on using a stress measure is too conservative and overly prescriptive. We suggest that the RTS should be revised so that CAs have scope to review the methodology defined by the firm rather than requiring the firm to base the estimate on the largest position over the past year.
40.	**Do Stakeholders consider appropriate the requirements established in this Article regarding the constant level of risk and constant position assumptions?** We would appreciate further clarity from the EBA on Article 63(4). Our understanding is that "irrespective of the methodology applied" means that this Article applies to either a constant level of risk assumption or a constant position assumption. However, point (b) refers to maturity mismatches occurring "within the liquidity horizon" which would only be applicable to a constant level of risk assumption.
41.	**Do stakeholders agree that internally-derived ratings shall be prioritised for IRC?** We agree that internally-derived ratings if available should be prioritised for IRC. Given the quantitative and qualitative requirements applicable to IRB model outputs (including model development standards, independent validation, data integrity, use test and supervisory approval) we believe that internally derived PDs (IRB and IRB-like) should be preferred.
42.	**Do you consider that PDs derived from spreads or external ratings are more appropriate for IRC modelling than those internally-derived?** In our view, PDs derived from credit spreads do not meet the same soundness standard as those derived internally particularly since credit spreads are subject to market-driven demand and supply factors and can be affected by market liquidity. While external ratings published by ECAIs are based on assimilated information relating to an issuer, at times they can lag actual changes in creditworthiness. Therefore, we

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	do not believe external ratings should take precedence over available internally-derived ratings for IRC modeling. Where internally derived PDs are not available, other methodologies, such as external ratings, should be acceptable once they have been through appropriate review by the CA.
43.	**Do stakeholders agree with the exclusion of zero PDs for IRC?** In our view this proposal is overly prescriptive as we do not agree that the RTS should mandate a PD floor. Although a firm should not assume that a zero PD applies, if its PD model generates a zero or near-zero PD then this should be allowed and not floored at a prescribed level. Instead we suggest that CAs should review the firm's methodology for deriving PDs for low default portfolios in light of IRB requirements.
44.	**Do stakeholders consider that losses due to default should be based on the market value or the instrument's principal?** in general, we consider that the market value is the best representation of the loss on default since it reflects the carrying value in the firm's books and records as well as the value that a trading desk views as its loss in the event of a default (typically measured as 'jump to default' or 'loss in default'). However for certain types of positions, such as zero coupon bonds and strips, this may not be the case. In our view this proposal is overly prescriptive since a firm should have scope to choose its model methodology as long as it remains in line with requirements relating to that model and CAs should be given the flexibility to review the firm's documentation and justification for its modeling choices.
45.	**Do Stakeholders have any additional comments or concerns regarding the requirements outlined in the IRC section?** We have two comments on Article 65 regarding transition matrices: 1. It is not clear to us how a transition matrix can be tested for conservatism or how this would be measured. Our expectation is that any conservatism metric would be portfolio dependent and therefore subject to changes in the risk profile of the trading book. 2. In our view, the requirement that "separate transition matrices are applied for specific groups of issuers and specific geographical areas" is not feasible given the scarcity of migration data for many industry sectors and regions. We agree that having a separate transition matrix for sovereign positions is meaningful; however, we would not propose using multiple transition matrices for non-sovereign positions since this could be detrimental to the integrity of the output.
46.	**Do Stakeholders have comments or concerns regarding the requirements outlined in the correlation trading section?** We believe that the requirement in Article 74 to evaluate the existence of a liquid two-way market for single-name credit derivatives at least quarterly is too prescriptive. We suggest that this point be revised to give CAs flexibility to review the procedures implemented by the firm to assess the availability and appropriateness of market data and the firm's rationale for its conclusion on the existence or otherwise of a liquid two-way market.

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